

THE CURSE OF OIL WEALTH

by Jonathan Reingold

“I know what I was doing was wrong and unlawful,” says a thin and graying J. Bryan Williams, speaking slowly into the microphone as he reads his guilty plea. “I believe I acted in concert with others,” he adds in monotone. But when the judge asks him to identify “CC1”—the still secret holder of another offshore account at the same Credit Agricole Indosuez Bank—he is at a loss for words. Fortunately, the young prosecutor is eager to assist the defendant and jumps up to announce that Mr. Williams is not required to reveal his co-conspirators.

Welcome to the oddities of a plea bargain. In this case, the US Attorney’s Office for the Southern District of New York is willing to make a deal because of the prospect of catching bigger prey.

J. Bryan Williams represented Mobil Oil in Russia, back when it was still the Soviet Union. In 1996, Mobil sent him to the Central Asian Republic of Kazakhstan to conclude an agreement to buy, for \$1bn, a 25% share in the Tengiz oil field, the largest field discovered in the last thirty years.

Spurred on by the prospect of what might be the largest violation ever of the

1977 Foreign Corrupt Practices Act, of which Mr. Williams's crime is but a small part, prosecutors claim Mr. Williams kept \$7m in unreported income in a Swiss bank account, including kickbacks amounting to \$2m from the Tengiz deal paid to him by James Giffen, an American business consultant. Mr. Giffen was chairman of a New York merchant bank, Mercator Corp., and special advisor to the President of Kazakhstan, Nursultan Nazarbayev. ¹

Giffen, arrested on 30 March 2003, was indicted on charges of channeling over \$78m in payments from Mobil and other western oil corporations to senior Kazakh officials. President Nazarbayev reportedly controlled at least one of the Swiss bank accounts in which the money was discovered.

As a news assistant for the London *Financial Times*, I sat in the courtroom and listened to the government's evidence against Mr. Williams. Between 1993 and 2000, he maintained a secret bank account under the moniker Alki Holdings, a fake company apparently designed solely so that he could evade over \$3.5m in taxes. When the defense counsel conceded that there was "no legal defense that would prevail in trial," there was little left to discuss.

Mr. Williams never admitted that the payments he received were kickbacks, although I watched him declare that the \$2m he received in 1996 was from "people,

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organizations and governments whom [he] did business on behalf of." All the same, "kickbacks" are exactly how the government described them in the plea bargain agreement.

On 13 June 2003, J. Bryan Williams pled guilty to conspiracy to commit fraud and tax evasion and agreed to a sentence of 46 to 57 months with no appeal. He also had to pay all his back taxes.

As for Mobil (ExxonMobil since 1999), it was doing its best to distance itself from the scandal. Ted Wells, counsel for the oil giant, told reporters outside the courtroom that the company was not a "target" of investigations involving bribery, and that Mobil, as Mr. Williams testified, had no knowledge of the secret payments. However, as early as April 2003, a US prosecutor said Mobil was a "subject" of the investigation, which has been underway in the US for the last three years.

Switzerland first launched investigations in 1999, during which time it froze 12 or more Kazakh bank accounts based on suspicion of money laundering. When the Kazakh government tried to lean on the Swiss to back off, the Swiss responded by sending documents from the case to the US Department of Justice. The documents provided the Department of Justice with the evidence to indict James Giffen and J.



Political Borders of Kazakhstan

Image © CIA Facebook

Bryan Williams. Mr. Giffen had negotiated almost all of Kazakhstan’s big oil agreements in the last decade, including the Kashagan offshore field, one of the six financial transactions that the indictment details. Notably, the Washington DC law firm which represents the Republic of Kazakhstan lobbied the US Deputy Attorney General to intervene in the

Giffen investigation and even met with Southern District of New York prosecutors in a failed attempt to secure a guarantee that President Nazarbayev would not face indictment.²

To play ball in Kazakhstan, most of the major American and European companies paid signature bonuses, a normal component of the bid process to demonstrate commitment by the companies. What makes these bonuses stand out is that the money went not to the Kazakh treasury but rather to bank accounts specified by the government. US prosecutors assert that the money was then moved piecemeal to other accounts or shell companies and so on until it finally landed in accounts held by Giffen, President Nazarbayev, Williams and others.³

Some might say that a little corruption in business is harmless, maybe even necessary. After all, outside the United States, bribes are often a completely legal and acceptable practice. In France and Germany for example, until the last few years, corporations were allowed to deduct “commissions” (a euphemism for bribes) on their tax returns, a far cry from the supposedly highly ethical American business standard. All the same, an \$80m bribe divided between a President, government officials, his American consultant, and a senior vice president at Mobil seems a little excessive. A press release on 2 April 2003 from the US Attorney’s Office for the Southern District of New York does not waste words: “In making these unlawful payments, Giffen also defrauded the people of Kazakhstan out of the honest services of its officials, defrauded the Republic of Kazakhstan out of millions of dollars from these oil transactions, and laundered money to promote and conceal his crimes.”⁴

It is hard to have sympathy for anyone involved, except for the people of Kazakhstan who are denied the benefits of their plentiful natural resources. Labeled the “Dutch Disease”⁵ or the “resource curse” by journalists, political scientists and economists, there is often a lack of GDP growth in countries with copious natural resources, compared to countries with few natural resources. A plentiful natural resource, especially oil, makes its host country prone to corruption, particularly as the profits it creates go largely offshore. In the case of offshore drilling, the joke is that the oil is offshore and the profits stay offshore. Corruption often occurs when the host-

government invites a multi-national oil or mining company to explore and later exploit their country's resource potential. Multi-nationals are the only organizations with the capital, technological know-how, economic incentive, and ability to take such large risks. The problem is that middlemen, such as Giffen, sometimes place themselves between the host-government and outside investors, and take hefty fees and collect payments from both sides while negotiating on the government's behalf.

What constitutes a hefty fee? When Giffen closed a 1993 deal for Chevron's stake in the Tengiz oil field, he reportedly charged \$0.075 for every barrel produced. Although the full contract is still secret, it is believed that Tengiz contains as many as 9bn barrels of crude.⁶ That's potentially a \$675m broker's fee.

Non-governmental organizations such as Global Witness, Transparency International, and, more recently, the foundations of George Soros have been pressuring oil companies to publish what they pay since at least the late 1990s. They have published exposés, such as *All the President's Men*, by Global Witness, on the looting of state revenue in the war-torn sub-Saharan nation of Angola. Implicated parties include Angolan President Jose Eduardo Dos Santos, French President Jacques Chirac, multi-national oil companies, international banks, and an eclectic coterie of other characters from arms dealers to President Bush and Vice President Cheney.

In Angola, Global Witness managed to pressure British Petroleum (BP) into disclosing its signature bonuses. However, in 2000, after BP Exploration disclosed its payment of a \$111m signature bonus for Angola's block 31 (an ultra-deepwater exploration zone off Angola's coast) and promised to continue to disclose its annual production and payments data, the Angolan state oil company and concessionaire, Sonangol, threatened to cancel BP's production-sharing agreement. Making an example out of BP quickly put an end to the desire of oil firms to voluntarily disclose their payments to the state.

Both Kazakhstan and Angola offer prime examples of how countries rich in oil can suffer, albeit in varying degrees, in economic development and political stability because of the very commodity that they see as their greatest hope. However, the resource curse theory fails to fully explain the cases of Kazakhstan and Angola, both countries that have experienced relatively modest to high GDP growth in recent years, but little or no economic development in other sectors besides the oil industry. They both also happen to be located in two regions of the world that the US government has singled out as strategically important for ensuring the future stability of US oil supplies in an era when the Middle East appears only to be increasing in volatility.

For both countries, the seemingly guaranteed continuous stream of oil revenue gives the government a disincentive to spend productively, to stimulate diversity in the domestic economy and its exports, or to establish a system of checks and balances that will make it easier for the government to borrow at reasonable rates. Currently, the IMF refuses to grant structural adjustment loans to Angola because the government apparently cannot account for billions in missing revenue. But why should Angola clean up its accounting so it can borrow millions from the IMF when it is earning billions from oil? Moreover, because the government needs to spend now, it

borrowed from international banks at high interest rates and relies on oil-backed loans from Export-Import banks (which exceed IMF limits). The result is an extremely inefficient allocation of resources, with a large portion of oil revenue going to finance loans at high rates of interest. The status quo means that there is no incentive for the government to crack down on corruption, as long as oil money is flowing.

A high GDP from oil revenue can mask serious problems in a country's economy, such as high unemployment and high inflation. The constant stream of this revenue, currently \$3bn per year in Angola, is almost single-handedly responsible for its average GDP growth rate (since 1995) of 6.6%. Inflation, however, stood at 2600% in 1995 and 108% in 2002.⁷

It is time that steps are taken to eliminate the Dutch Disease, to ensure that the majority of the profits from oil exploitation go to the people who live in that country. This is not an absurd idea. Since 1978, Angolan law has stipulated that "all deposits of liquids and gaseous hydrocarbons...belong to the Angolan people."⁸

A question worth asking, then, is how to keep the governments of oil-rich developing states from engaging in corrupt acts and retarding economic growth and political stability in their countries. Using international pressure to curb corruption

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and promote transparency in the transactions between multi-national oil companies and host-governments is a logical place to start, but it is by no means an easy task. NGO pressure campaigns directed at the oil industry can only go so far. Individually, oil companies will not voluntarily publish what they pay around the world unless they are forced to do so universally. The chance of universal regulation being enacted is very slim but worth exploring, especially the prospect of global cooperation between securities commissions to implement consistent disclosure rules for resource extraction companies.

Intuitively, one might think oil companies would benefit if transparency and accounting standards were monitored and enforced universally. The current undisclosed signing bonuses would lose their allure as the amounts would be public knowledge, and citizens would have access to crucial information, namely state revenue, by which to hold their government accountable for where and how it spends their money. This plan would promote a level playing field in the market for oil exploration and drilling. The winner would be the company best able to fulfill its contract-winning bid, instead of the one which offered the biggest bribe. Who would lose with mandated transparency? Corrupt government officials, foreign middlemen and, frequently, arms dealers.

If only it were that simple.

One problem is that greater transparency in the bidding process does not automatically lead to greater efficiency in the form of lower signing bonuses and fewer opportunities for government officials to steal state revenue. In many cases, signing bonuses are above board, and they are still outlandishly high, sometimes even higher than if the bidding were secret. The real problem is to whom exactly the signing bonus goes, which is, needless to say, not always to the state treasury, but rather to private off-shore bank accounts held by government officials. And, beyond signing bonuses, all too often outright bribes decide if a company will win a contract or not.

A former president of a \$40 billion multi-national oil company told me that he was “personally involved in arguing back and forth with the head of a state oil company [in Africa].... Where the state oil company indicated if we did a certain thing, [read: pay some form of bribe] we would get the contract. We didn’t and were respected later on in the country for it.”⁹ The company that won the contract did not even participate in the bidding process, but coincidentally, a new palace was built for the country’s president, presumably paid for by the winning company.

According to Jack Blum, an attorney specializing in international criminal

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law, “The signing bonus is the just the tip of the iceberg... It is not just discovering the oil, but being able to market it, refine it, control distribution choke points... [Bribes are paid to] pay people off not to produce, pay people not to construct terminals... The opportunities are quite amazing, quite endless.”¹⁰

So the problem is not just the legal signature bonus tool, but the lack of uniform disclosure standards. Here is the crucial question: how much does the winning company pay for a contract, and where does the money from the signature bonus and any other payment go?

If the aim is to enforce uniform disclosure standards and undermine the effects of the resource curse, two fundamental questions follow: first, does an existing regulatory body have the authority and ability to enforce disclosure of payments by multi-national oil firms globally? The solution does not lie in one agency alone enforcing its will but rather in multiple international bodies, state actors, and non-state actors collaborating to deter corruption, recover stolen state assets, and design the proper incentives for oil-rich countries seeking financial assistance. As Blum put it, “The bottom line is all the people that steal the money get to keep it.” For him, the answer to combating corruption in the oil industry is “to go after it post facto, by country and by entity,” and there has to be an understanding by the international community that bribery money is contraband. The UN Convention Against Corruption, the Extractive Industries Transparency Initiative (EITI), the G8 and the IMF/World

Bank should all be fully utilized to this end.¹¹

Second, considering political realities, should disclosure by oil companies, and, equally important, host-governments, be voluntary or regulatory? While I am not satisfied that voluntary treaties will reach the most severely afflicted countries, I see little hope of enforcing regulatory standards on countries against their will. A more realistic goal is that disclosure of payments by publicly traded oil companies should be regulated across the board. The IMF and World Bank should only offer below market rate loans to Highly Indebted Poor Countries¹², with loans conditional on public audits for the duration of the loan. All countries exporting natural resources should adopt the Extractive Industries Transparency Initiative if it proves effective, and the IMF and World Bank should engage in more aggressive debt forgiveness for heavily indebted resource-rich countries.

The key to mitigating the resource curse and deterring corruption is to strike the right balance in the tactics used by the World Bank Group, the UN, and foreign governments. This will hold multi-national corporations to universal standards of transparency, while forcing international finance institutions to make loans on soft terms, conditional on transparency, rather than perpetuating reliance on royalties from extractive industries.

Jonathan Reingold is a graduate of Bard College (B.A., Political Studies). During the Spring of 2002, he attended the Bard Program on Globalization and International Affairs and interned at the Arms Trade Resource Center of the World Policy Institute. This article was adapted from his senior thesis, which he wrote under the guidance of the late Professor James Chace at Bard College.

1 Joshua Chaffin and Jon Reingold, "Mobil's man in Kazakhstan admits fraud," *Financial Times* 13 June 2003: A18.

2 Eurasianet.org, 8 April 2003.

3 Marcus Walker and Steve Levine, "Swiss Probe Kazakh Oil Deals For Alleged Bribery of Officials," *The Wall Street Journal Online*, 6 May 2003.

4 US Department of Justice press release of Giffen/Williams indictment available at <http://www.usdoj.gov/usao/nys/Press%20Releases/April03/GIFFENWILLIAMS.pdf>.

5 "Dutch Disease" refers specifically to exchange rate appreciation in resource-rich countries.

6 Joshua Chaffin and David Stern, "Kazakhstan's gatekeeper becomes a legal liability," *Financial Times* 15 April 2003.

7 Tony Hodges, *Angola: Anatomy of an Oil State*, (Lysaker, Norway: Fridtjof Nansen Institute in association with James Currey & Indiana University Press, 2001 and 2004) 59, 172; based on World Bank figures.

8 *All The President's Men*. London: Global Witness, 2002. Reference to Angolan Law No. 13/78.
Promulgated 26 August 1978.

9 Anonymous source, phone interview, 21 Nov. 2003.

10 Jack Blum, phone interview, 24 Nov. 2003. Blum is a former US Senate Investigator on
International Financial Crime, Corporate Fraud and Government Corruption, and Consultant to the
US Department of Justice and the IRS on International Financial Crime and Offshore Tax Evasion.
He is a partner in the Washington, DC law firm of Lobel, Novins & Lamont.

11 Launched in 2002 by British Prime Minister Tony Blair at the World Summit on Sustainable
Development in Johannesburg, the EITI aims to encourage governments, public and private extrac-
tive companies and NGOs to work together voluntarily to create a revenue reporting framework
that promotes transparency. As of June 2003, seven countries have volunteered to participate in a
pilot program, including Nigeria, Sierra Leone and Azerbaijan. Notably, Angola has said it would
remain only an "Observer" to the EITI. The G8, in support of the EITI, issued its Declaration on
Fighting Corruption and Improving Transparency after the Evian, France summit in June 2003. The
G8 nations pledged to encourage private and state-owned companies as well as governments to
disclose revenue flows and payments, and to encourage the IMF and World Bank to provide the
technical support necessary to achieve higher standards of transparency in public revenue manage-
ment.

While the EITI lacks an asset-recovery provision, in November 2003, the UN General
Assembly passed the Convention Against Corruption, the first global anti-corruption treaty requiring
countries to return stolen assets from the countries of origin. Most importantly, the treaty criminal-
ized bribery, embezzlement of public funds and money laundering, as well as providing the legal
mechanisms to return the stolen assets. Previously, money laundering as the proceeds of corrup-
tion was not criminalized by international law. It also declares that acts supporting corruption or
obstructing justice in corruption investigations should be considered crimes. Alas, the US, which
backed the treaty as a tool to use against money laundering by terrorist groups, succeeded in elimi-
nating a mandatory prohibition on bribery in private industry.

12 In 1996 the IMF and World Bank launched the HIPC Initiative to tackle debt reduction in the most
debt-laden poor countries that are pursuing IMF/World Bank sponsored adjustment programs. As of
this September, 27 HIPC countries have had debt-reduction packages approved; 23 were in Africa,
allotting \$32bn in debt service relief over time.

To be considered for HIPC assistance, a country must: 1) face an unsustainable debt
burden, beyond traditionally available debt-relief mechanisms; 2) establish a track record of reform
and sound policies through IMF/World Bank programs; and 3) have developed a Poverty Reduction
Strategy Paper (PRSP). See IMF September 24, 2004 Factsheet: How the IMF Helps Poor
Countries at <http://www.imf.org/external/hp/exr/facts/hipc.htm>.